

LIMITED INSOLVENCY EXAMINATION • EXAM PREP SERIES

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# Income-tax Act, 1961 in Insolvency

Provisions an Insolvency Professional Must Keep in View

Tax claims & the waterfall • losses • amalgamation & demerger • slump sale • haircuts & MAT • share allotment & tax holidays  
liquidation: capital gains, TDS, s. 178 • going-concern sale • voluntary liquidation • moratorium & compliance

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## ORIENTATION

# The Two-Code Interface & the Clean-Slate Doctrine

### The governing principle

- Ghanashyam Mishra (SC, 2021): on approval of a plan u/s 31, all claims — including tax dues — not in the plan stand extinguished.
- IBC overrides the Income-tax Act (s. 238) in case of conflict.

### Operationalised in the tax statute

- s. 156A: AO shall modify a demand reduced pursuant to an IBC order.
- s. 170A: successor entity files a modified return (rule 12AD) to give effect to the plan.

### Roadmap of this deck



Claims & priority



Resolution



Liquidation



Compliance



Moratorium



## Status of Tax Claims & Rank in the Waterfall

### Operational creditor — and not secured

- Pre-CIRP tax dues are sums due to Government = operational-creditor claims (Ghanashyam Mishra; Akshay Jhunjunwala).
- Tax dues are Crown debts — they do not precede even private secured creditors (Dena Bank; Monnet Ispat, SC).
- The Department is not a secured creditor and must recover via s. 53 (Leo Edibles).
- A secured creditor must prove its interest via IU / RoC charge / CERSAI (Reg. 21, Liquidation Regs; s. 26B SARFAESI).

### Where it ranks — s. 53(1)

- Government dues (incl. income-tax) sit at clause (e)(i) — after costs, workmen, secured creditors, employees and unsecured financial creditors.
- Hence the revenue recovers little in liquidation.

**Rainbow Papers — verify before relying:** the 2022 ruling treated a State with a statutory charge as a secured creditor. It has been read narrowly / distinguished by later benches on the priority of statutory dues. Treat as evolving and confirm the current Supreme Court position.

# Carry-Forward & Set-Off of Losses

## Section 79 — the general fetter

- Closely-held company: brought-forward business loss survives only if  $\geq 51\%$  voting power stays with the same beneficial owners.
- A plan changes control by  $>49\%$  — losses would normally LAPSE. (s. 79 does not apply to listed companies.)

### s. 79(2)(c) — the IBC carve-out

- The s. 79(1) bar does not apply where the change is pursuant to an IBC-approved plan.
- Condition: reasonable opportunity of hearing to the jurisdictional PCIT / CIT.
- Parallel carve-out for a s. 242 Companies Act plan (company + subsidiary chain).

## Allied points

- s. 72: business loss carries forward 8 AYs; s. 32(2) unabsorbed depreciation has no s. 79 fetter.
- s. 72A: on a merger/demerger within the plan (Reg. 37), accumulated loss & depreciation carry forward subject to conditions.
- Losses must be duly determined in returns filed in time (s. 139(3)/80).

**Trap:** no s. 79 carve-out for a going-concern sale in liquidation — see Part C (s. 79(2) requires a resolution plan).

## Amalgamation — Tax Neutrality & Loss Transfer

### Neutrality on transfer

- s. 2(1B): merger of companies; assets/liabilities move at book value.
- s. 47(vii): a shareholder is not taxed on exchanging shares for shares in the amalgamated company — which must be an Indian company.
- Bonds/debentures in lieu of shares break neutrality (Gautam Sarabhai Trust).

### s. 72A — accumulated loss & depreciation

- Conditions met → business loss fresh 8 years; unabsorbed depreciation indefinitely.
- Conditions later breached → set-off allowed is deemed the transferee's income [s. 72A(3)].

### Two reliefs candidates forget

- MAT credit (s. 115JAA) of the transferor passes to the transferee (SKOL Breweries; Caplin Point; Ambuja Cements).
- On a later sale, indexation runs from the date the asset was FIRST held (Kotak Mahindra; Manjula Shah).

### Watch-outs

- “Accumulated loss” = business loss only; b/f house-property & capital-gains losses are lost to both companies.
- Depreciation is apportioned in the ratio of days used by each [proviso to s. 32(5)].

## Demerger — Conditions, Cost Split & Losses

### s. 2(19AA) — what qualifies

- All property & liabilities of the undertaking transferred at book value, on a going-concern basis.
- Resulting company issues shares to the demerged company's shareholders.
- $\geq 3/4$ ths of the demerged company's shareholders become shareholders of the resulting company.
- Cherry-picking is fine if what moves is itself a running business (Indo Rama Textile).

### Neutrality, cost & losses

- s. 47(vii): issue of resulting-company shares to the demerged company's shareholders is not a transfer; s. 2(22)(v): no dividend.
- Cost split [s. 49(2C)/(2D)]: resulting-co share cost = original cost  $\times$  (net book value transferred  $\div$  net worth); demerged-co cost = original less that figure.
- Loss / unabsorbed depreciation directly relatable to the transferred undertaking  $\rightarrow$  resulting company; if not, apportioned in the asset-retention ratio.

## Slump Sale — Section 50B

### Mechanics

- s. 2(42C): transfer of an undertaking, by any means, for a lump sum without values assigned to individual assets/liabilities.
- Capital gain = consideration – net worth (depreciable assets at WDV per s. 43(6); others at book value).
- Revaluation ignored; no indexation. LTCG if undertaking held >36 months. Report in Form 3CEA.

**Slump exchange:** FA 2021 widened “slump sale” to all transfers but wrote “sale” not “transfer”; FA 2022 fixed the slip. FVC may be deemed FMV (Rule 11UAE).

### Three rulings to know

- Artex Manufacturing (SC): if individual asset values are assigned/attributable, it is NOT a slump sale.
- Zuari Industries (Mum.): if net worth is NEGATIVE, the entire consideration is capital gain.
- DE Nora India (Del.): the purchaser may allocate values to the assets/liabilities acquired.

*Note: business loss / accumulated depreciation stays with the transferor.*

## Taxability of Haircuts — Loan Waivers

### s. 41(1)

Remission / cessation of a TRADING liability on which a deduction was earlier allowed is deemed income. Catches operational / trade creditors.

### s. 28(iv)

Value of a benefit from business. As historically worded, covered benefits in NON-monetary form only.

### Mahindra (SC, 2018)

Cash waiver of a CAPITAL loan held not taxable — not a trading liability (41(1)) and not a non-monetary benefit (28(iv)).

**Track the update:** FA 2023 widened s. 28(iv) to bring benefits received in cash within its net — diluting the Mahindra shelter for cash loan waivers. A live, examinable area.

**MAT overlay:** even if not taxable normally, the write-back raises book profit → potential MAT u/s 115JB, mitigated by the CIRP relief (next slide).

## MAT Relief for a Company Under CIRP

### Normal rule — s. 115JB

- Book profit is reduced by the LOWER of brought-forward loss or unabsorbed depreciation per the books [clause (iii)].
- If either is nil, nothing is reduced — MAT bites.

### CIRP relief — clause (iih)

- For a company whose CIRP is admitted u/s 7 / 9 / 10, book profit is reduced by the AGGREGATE of brought-forward loss AND unabsorbed depreciation (not the lower of the two).

### Why it matters

- Restructuring may wipe the carried-forward figure from the books, leaving a tax on the write-back of liabilities — exactly what clause (iih) neutralises.
- Inserted by the Finance Act 2018. Model the MAT impact before the plan is voted on.

## Share Allotment to the RA & Tax Holidays

### Allotment of shares to the RA

- s. 56(2)(x): receipt of shares below fair market value can be taxed in the recipient's hands.
- s. 50CA: FMV is substituted as consideration on transfer of unquoted shares below value.
- FMV is computed under Rule 11UA — there is NO specific carve-out for IBC cases.

**Open issue:** is a fresh fair valuation needed when value has already emerged through the IBC process? Flag it in the plan.

### Tax holidays — 10A / 10AA / 80-IA

- Common conditions: the undertaking must not be formed by splitting up / reconstruction, nor by transfer of previously-used plant & machinery.
- The benefit attaches to the UNDERTAKING, not the assessee — a change in name or shareholding does not, by itself, disentitle it (Tata Communications, cited in Ultratech).
- No clarity yet for slump sale, IBC resolutions, or a going-concern sale in liquidation.

## Giving Effect to the Plan in Tax

### Succession — s. 170 / 170A

- s. 170(2A) [non-obstante]: a proceeding made/initiated on the predecessor during the pendency of succession is deemed made on the successor.
- “Pendency” runs from admission of the CIRP application to receipt of the AA's order by the PCIT/CIT.
- s. 170A (rule 12AD): the successor files a MODIFIED return to give effect to the reorganisation — which includes IBC.

### Demand modification — s. 156A

- Where a demand is reduced pursuant to an IBC order, the AO SHALL modify it accordingly.
- The section's language suggests a power in the AA to modify a demand as part of the resolution process.
- Together with the clean-slate rule (Ghanashyam Mishra; Essar Steel), this protects the RA from legacy and undecided claims.

## Capital Gains on Realising the Estate

### Distribution in specie — ss. 45 / 46

- s. 46(1): distribution of assets to shareholders on liquidation is NOT a transfer by the company.
- s. 46(2): the shareholder is taxed on money/assets received, less the s. 2(22)(c) deemed-dividend element.

### But in practice — assets are SOLD

- The liquidator usually SELLS assets → ordinary s. 45 gains arise in the corporate debtor's hands.
- Contested: is that tax a liquidation cost, or a s. 53 due? NCLT Allahabad in LML Ltd. — payable per s. 53.

### Going-concern sale — do liabilities follow?

- Neither sale of the CD nor of its business as a going concern carries ALL pre-CIRP liabilities to the buyer — only those earmarked by the CoC / liquidator (Kashvi Power & Steel, Calcutta HC).
- Do not confuse the s. 46(1) no-transfer rule (in-specie) with an actual sale (taxable s. 45 gain).

## TDS on a Liquidator's Sale — s. 194-IA

### The provisions in play

- s. 194-IA: buyer deducts 1% TDS on immovable property where consideration  $\geq$  ₹50 lakh.
- s. 194Q / 206C(1H): TDS / TCS where inventory or goods are sold.

### The conflict & its resolution

Deduction at source shrinks the estate and disturbs s. 53. By s. 238, the waterfall prevails — TDS cannot defeat it (Om Prakash Agarwal, NCLAT; Pooja Bahry v. Gee Ispat). The liquidator seeks NCLT directions or a lower/NIL certificate u/s 197.

### Practitioner checklist

- Assess TDS/TCS exposure on each asset class before sale.
- Apply for a s. 197 lower / NIL deduction certificate to preserve estate value.
- Where the buyer insists on deducting, seek the AA's directions to protect the s. 53 priority.
- Keep the waterfall, not the buyer's convenience, as the governing rule.

## Section 178 and Its IBC Override

### s. 178 — the ordinary scheme

- Liquidator notifies the AO within 30 days of appointment.
- AO intimates the tax payable within 3 months.
- Liquidator sets aside that amount before parting with assets.

### The IBC override — s. 178(6)

- Amended w.e.f. 01.11.2016: “save as otherwise provided in the IBC, 2016.”
- The s. 53 waterfall **DISPLACES** the set-aside; but the notice requirements, not conflicting, must still be met.
- IBC overrides via s. 238 (S R Foils; ABW Infrastructure) — yet not to be read inconsistently with other laws (Dishnet Wireless).

**Common MCQ trap:** candidates wrongly apply the full s. 178 set-aside in an IBC liquidation. Post-01.11.2016 the Code's priorities prevail.

## Going-Concern Sale: Liquidation vs CIRP

	GCS in LIQUIDATION	GCS in CIRP (resolution plan)
Carry-forward of losses	No statutory carve-out; benefit only with the income-tax authority's permission (Topworth Pipes; PSL Ltd. / Nitin Jain; Sterling Biotech).	s. 79(2)(c) lifts the s. 79(1) bar, after a PCIT / CIT hearing.
AA's power to grant relief	Limited to reliefs central to the liquidation [s. 60(5)(c)]; new management to approach the IT authority.	AA cannot itself waive tax; RA applies to the competent authority (Bhushan Steel; DHFL).

**Bottom line:** the loss carve-out is the key difference — automatic for a resolution plan, discretionary (and authority-dependent) for a liquidation GCS.

## Voluntary Liquidation — Shareholder Tax

### In the company's hands

- s. 46(1): distribution of assets to shareholders on liquidation is NOT a transfer by the company.
- So no capital-gains charge arises on the company merely for distributing in specie.

### In the shareholder's hands

- s. 2(22)(c): the part attributable to accumulated profits is DEEMED DIVIDEND.
- s. 46(2): the balance (money / market value of assets received, less the deemed-dividend element) is taxed as CAPITAL GAINS.

**Post-01.04.2020:** with DDT omitted, the deemed dividend is taxable in the shareholders' hands.

## Moratorium and Ongoing Compliance

### s. 14 moratorium & tax proceedings

- Bars institution / continuation of suits and RECOVERY against the CD.
- ASSESSMENT (quantification) generally continues; coercive recovery / account-freezing is barred (Monnet Ispat; Kitply Industries).
- Adjustment of refunds against dues offends ss. 14 / 33 / 53 / 238.

**Distinguish:** quantify = allowed during moratorium; recover = stayed. A favourite examiner distinction.

### Going-concern compliance by the IP

- File income-tax & TDS returns, deduct & deposit current TDS, pay advance tax — current taxes are CIRP COSTS.
- s. 140 r/w rule 12AA: the return is verified by the IP; s. 288(2)(viii) r/w rule 51B: IP may act as authorised representative; s. 238(2): liquidator may claim refunds.
- Reg. 27A/27B: an IP shall not load penalties for its OWN non-compliance into CIRP / liquidation cost. (s. 276A decriminalised by FA 2023.)

## QUICK-REVISION MENTAL MODEL

# Seven things to carry into the exam hall

- 1 Plan approval = clean slate** Legacy tax dues not in the plan are extinguished — s. 156A / 170A (Ghanashyam Mishra).
- 2 Applicant inherits losses** s. 79(2)(c) for a plan; s. 72A on a merger/demerger; s. 32(2) depreciation is free of s. 79.
- 3 Restructuring is tax-neutral** Amalgamation (47(vii)) & demerger (47(vii)) — plus MAT credit carry-over (115JAA) and the demerger cost-split.
- 4 Slump sale = FVC – net worth** Negative net worth → whole consideration is gain (Zuari); assign values → not a slump sale (Artex).
- 5 CIRP softens MAT & waivers** Aggregate loss + depreciation under 115JB(iih); Mahindra on waivers — now watch FA 2023 on s. 28(iv).
- 6 IBC overrides in liquidation** s. 53 trumps s. 178 and s. 194-IA; s. 197 protects the estate; NO s. 79 carve-out for a liquidation GCS.
- 7 Tax dues rank low** Government dues at clause (e)(i) of s. 53 — quantify during moratorium, recover by rank.



## Master the interface, add value to every plan.

Income-tax shapes plan value, distribution and the IP's own compliance duties — across resolution and liquidation alike.

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